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13 Chapter 11 Trustee

14 UNITED STATES BANKRUPTCY COURT
15 NORTHERN DISTRICT OF CALIFORNIA
16 OAKLAND DIVISION

17 In re ROME FINANCE CO., INC.,
18 Debtor.

19 Case No. 08-45902 EDJ
20 Chapter 11
21 Hon. Edward D. Jellen

22 **MOTION TO COMPROMISE**
23 **CONTROVERSY**
24 **(Attorney General, Tennessee)**

25 [No hearing requested, unless objection filed]

26 David A. Bradlow, Chapter 11 Trustee of the estate of the above-named Debtor, hereby
27 moves the Court for an order authorizing him to enter into a compromise with the Attorney
28 General of Tennessee, and respectfully represents as follows:

- 29 1. Movant is the duly appointed, qualified and acting Chapter 11 Trustee in this case.
- 30 2. On October 14, 2011, the Trustee served on creditors and other interested parties
31 and electronically filed as docket entry number 636 his Notice of Trustee's Intent to Request
32 Order Authorizing Compromise of Controversy (Attorney General, Tennessee) (the "Notice"). An
33 authentic copy of the Notice is attached to the Declaration of Diana D. Herman filed in support of

1 this Motion.

2 3. By his Notice, the Trustee disclosed to creditors his intent to request an order
3 authorizing him to enter into a compromise concerning any and all claims asserted by the State of
4 Tennessee, through the office of its Attorney General, Robert E. Cooper, Jr. ("TN AG").

5 4. The purpose of this motion is to provide the Court with information to support the
6 Trustee's request to compromise with the TN AG.

7 **I. SUMMARY OF COMPROMISE**

8 If the compromise is approved, any issues related to three claims filed by the Attorney
9 General on April 13, 2009, totaling \$10,843,591.31 will be resolved. The Trustee will pay the
10 Attorney General the sum of \$1,300,000 in cash. Additionally, Claim No. 331 filed April 13, 2009
11 in the sum of \$1,395,000 will be allowed, but as a subordinated claim in a Compromise Plan or
12 pursuant to Bankruptcy Code Section 726(a) (4), if applicable. No further distribution is
13 anticipated based on this claim.

14 **II. BACKGROUND**

15 **A. The Lawsuit**

16 The action by the Attorney General against the Debtor and others was a substantial cause
17 of the Debtor seeking relief under Chapter 11 of the Bankruptcy Code. The Debtor spent very
18 substantial sums unsuccessfully defending that litigation.

19 In 2005, in the circuit court of Montgomery County, Tennessee for the Nineteenth Judicial
20 District of Clarksville, Tennessee, the Attorney General filed a lawsuit entitled State of Tennessee,
21 Plaintiff versus Britlee, Inc. dba The Military Zone aka Militaryzone.com and others, including the
22 Debtor, action no. 505-00-795 before the Hon. Ross Hicks (the "Lawsuit").

23 In the Lawsuit, the Attorney General asserted that there were numerous victims of the
24 Debtor's alleged unfair and deceptive acts or practices, primarily young men and women serving
25 in the United States military.

26 The Lawsuit culminated in a judgment against the Debtor totaling approximately
27 \$10,843,591 . The judgment was entered as a sanction, but with the state court finding that the
28 Debtor engaged in various unlawful and predatory sales and lending practices. The findings

1 entered in the Lawsuit noted the numerous times the Debtor was in civil contempt for violating
2 that court's orders. Prior orders and the judgment included provisions prohibiting the Debtor from,
3 among other things, doing any business or collecting any debt in Tennessee.

4 The Debtor, in response to the judgment and findings entered in Tennessee, argued that the
5 default judgment against it was based on purported discovery abuses, with the Debtor never
6 having the opportunity to present its defense on the merits. The Debtor argues it has a meritorious
7 appeal and defenses to the Lawsuit.

8 Right after filing for relief under Chapter 11 of the Bankruptcy Code, the Debtor filed
9 adversary proceeding No. 08-04299 (the "Adversary Proceeding") before the Bankruptcy Court
10 seeking injunctive relief against the Attorney General. The judgment against the Debtor in the
11 Lawsuit called for the Debtor to set aside \$1,200,000. Since a judgment had been entered against
12 the Debtor in Tennessee, the Adversary Proceeding became moot so the Trustee stipulated to
13 dismissing it.

14 The Trustee concluded that the judgment in favor of the Attorney General, as the estate's
15 largest creditor, needed to be addressed. Accordingly, the Trustee had conference calls with
16 various representatives from the Attorney General's office and traveled to Tennessee to meet
17 representatives from the Attorney General's office, as have members of the Official Committee of
18 Unsecured Creditors (the "Committee").

19 **B. The Trustee's Appeal**

20 Shortly after his appointment, the Trustee consulted with the Committee and concluded
21 that a Notice of Appeal would be filed concerning the judgment against the Debtor. The appeal
22 was filed as a protective matter. Ultimately, the state court in Tennessee concluded that the appeal
23 was interlocutory because the Lawsuit was not complete. The appeal was dismissed.

24 In 2010, the Lawsuit was concluded by settlement with the remaining defendants.
25 Therefore, a "final" judgment was entered in favor of the State of Tennessee against all remaining
26 defendants. Accordingly, while the Trustee continued to negotiate with representatives from the
27 Attorney General regarding a possible settlement with the Trustee, a new Notice of Appeal was
28 filed to preserve whatever rights the Trustee had concerning the Lawsuit.

1 Settlement negotiations were ongoing. The Attorney General agreed to extend the time
2 period under which the Trustee would need to file an Appellant's Opening Brief in the State of
3 Tennessee. The documents necessary to continue that appellate process were filed with the Court
4 of Appeals in the State of Tennessee. The Court of Appeal in Tennessee has granted an extension
5 until October 14, 2011. (A further extension has been requested.)

6 **C. The Attorney General's Claims**

7 Based upon its judgment against the Debtor, the Tennessee Department of Commerce &
8 Insurance-Consumer Affairs, in care of the Attorney General filed three claims in this case, as
9 follows:

11	Claim No. 329 filed April 13, 2009 in the sum of	\$8,894,706.06
12	Claim No. 330 filed April 13, 2009 in the sum of	\$553,885.25
13	<u>Claim No. 331 filed April 13, 2009 in the sum of</u>	<u>\$1,395,000.00</u>
14	TOTAL:	\$10,843,591.31

15
16 The largest Claim No. 329 seeks restitution and damages. Claim 330 seeks attorneys' fees.
17 Claim 331 is a penalty to punish the Debtor.

18 **D. The Attorney General's Position**

19 The Attorney General has argued that it obtained a judgment in the sum of \$10,843,591.
20 Further, it has argued that while the judgment may have been entered based on discovery abuses
21 by the Debtor, prior orders were entered, including an injunction against the Debtor and certain
22 stipulated orders which the Debtor violated. Therefore, it is not unusual because of the abusive
23 actions of the Debtor to have a judgment entered against such a party.

24 The Attorney General asserts that it has a valid judgment that will survive appeal. The
25 Attorney General has asserted repeatedly that the Debtor's activities during the course of the
26 litigation were outrageous and that orders were violated and ignored. The Attorney General further
27 asserts that the Debtor's acts resulted in damage to and abuse of Tennessee residents.

28 The Attorney General asserts that the data to determine the restitution portion of its claim

1 was gathered based on the information provided by the Debtor (although it took many months to
2 obtain the information and it was provided in a disjointed fashion). The restitution claim was
3 determined by an individual that was authorized by the Court in Tennessee to analyze all of the
4 Debtor's data and to come up with figures. As noted, the Attorney General asserts that the figure is
5 accurate down to the penny and based upon data provided by the Debtor.

6 The Attorney General likewise argues that while the Trustee has asserted that penalties are
7 subordinated, that occurs in a Chapter 7 case, not in a Chapter 11 case. Further, by its terms,
8 Bankruptcy Code Section 726(a)(4) is applicable only in a Chapter 7 case.

9 The Attorney General has repeatedly argued that its claims as asserted are valid, allowable,
10 and should be treated in the same fashion as any other general unsecured creditor, in that, they
11 represent the damage done by the Debtor to primarily military personnel that were under the
12 jurisdiction of the Tennessee Consumer Protection laws.

13 **E. The Trustee's Position**

14 Over the course of many months, the Trustee and representatives of the Attorney General
15 have discussed the judgment, the attorney fee issue, and the penalty portion of the judgment. The
16 Trustee has taken the position that, under the terms of Bankruptcy Code § 726(a)(4), penalties are
17 subordinated. Therefore, under certain provisions of Chapter 11 applicable upon plan
18 confirmation, i.e., Bankruptcy Code § 1129(a)(7), the Attorney General can not receive any
19 money based upon its penalty. Further, the Trustee challenged the restitution portion of the
20 Attorney General's claim, arguing that the definition of a "Tennessee resident" was too broad and
21 included parties that were not actual residents of Tennessee. The Trustee provided examples of
22 people that were included in the "Tennessee list" which, according to the Debtor's records,
23 included people that did not live in the State of Tennessee at the time they entered into contracts
24 with vendors at issue.

25 The Trustee asserted that, based on the analysis he was able to obtain and review, based
26 upon certain checking of contracts, the "list" compiled by the Attorney General included parties
27 that should not have been included, thus increasing its restitution claim, as noted above, to
28 \$8,894,706.

1 From the beginning of the case, as noted, the Trustee recognized that the \$10,843,591
2 claim in favor of the Attorney General was a substantial claim in this estate and needed to be
3 addressed. Negotiations have occurred over many months. Letters were exchanged, presenting
4 various positions, most importantly with both sides attempting to analyze the financial
5 wherewithal of this estate.

6 The Trustee recognizes and explained in the Joint Disclosure Statement sent to creditors
7 (the "Statement") that, under any set of circumstances, the Attorney General would be entitled to a
8 claim in this estate, even if the claim asserted by virtue of the judgment in Tennessee was
9 subordinated and/or found to be a penalty in its entirety.

10 As noted above, the judgment occurred prior to the Trustee's appointment. The Trustee has
11 been in the position of attempting to resolve the claim, while addressing the procedural issues
12 related to the appeal. The Trustee retained special counsel to prosecute the appeal.

13 From an economic standpoint, the Trustee has concluded that paying the Attorney General
14 \$1,300,000 is in the best interest of the estate. The Statement explained the compromise – no
15 objections were raised.

16 The Trustee looked at this over many months and, as noted, met with representatives from
17 the Attorney General's office, analyzed data supplied by his financial analyst, and recognized that
18 substantial sums were spent to litigate with the Attorney General. The record of the Lawsuit is
19 exhaustive. It involves 103 technical record volumes, with 11 transcripts, 19 exhibits and 41
20 volumes and 23 envelopes of miscellaneous documents. According to the Trustee's special
21 counsel in Tennessee, the issues are complex and the review of the record and the 11 transcripts
22 for preparation for filing an appellant's opening brief would be time-consuming.

23 The Trustee can not be sure exactly what the total dollar amount of the claim in favor of
24 the Attorney General would be without spending very substantial sums to check literally
25 thousands of contracts. When discussing this issue with counsel for the Attorney General, the
26 Trustee raised issues regarding certain people that were included that should not have been
27 included. The Attorney General's representatives presented information showing that there were
28 people that were not included that should have been included.

1 Accordingly, under any set of circumstances, the Trustee believes that the Attorney
2 General will have a claim in this estate. While it might not be \$10,843,591, it would end up being
3 quite substantial. Accordingly, the Trustee believes that settlement is appropriate.

4 **III. THE COMPROMISE**

5 Approval or rejection of a compromise is within the Court's discretion. In considering the
6 approval of a proposed compromise, the Court must take into account the following factors:

- 7 1. The probability of success in the litigation;
- 8 2. The difficulty, if any, to be encountered in collection;
- 9 3. The complexity of the litigation involved and the expense, inconvenience, and
10 delay necessarily attending it; and
- 11 4. The paramount interest of creditors and proper deference to their reasonable views.

12 *In re A&C Properties*, 784 F.2d 1377, 1381 (9th Cir. 1986).

13 As noted above, the Trustee has addressed the foregoing points. While the Trustee might
14 initially be successful in a determination that the claims asserted by the Attorney General are
15 penalties, notwithstanding that conclusion, assuming it occurred, the Trustee recognizes and
16 agrees that the Attorney General would end up with a very substantial claim in this estate.

17 With respect to collection, there is no issue in that regard, nor is there any issue regarding
18 payment. The Trustee believes that the payment of the \$1,300,000 to the Attorney General is less
19 than it will receive if it were paid under a plan of reorganization.

20 With respect to complexity, expense, and inconvenience, first, the Lawsuit lasted
21 approximately three years and substantial sums were spent by the Debtor (approximately \$2
22 million). As indicated above, the appeal would be very expensive and could only be the beginning
23 of a lengthy process, in that, even assuming the judgment were set aside, the claim asserted by the
24 Attorney General would still need to be liquidated. Such a procedure would be very expensive for
25 the Attorney General and for the Trustee.

26 With respect to the interest of creditors, the Committee supports the settlement as
27 proposed.

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1 WHEREFORE, the Trustee prays for the entry of an order authorizing him to enter into the
2 compromise with the TN AG, as described in his Notice. The Trustee will request such an order
3 when appropriate by a request for entry of order by default, assuming no objections are filed.

4 DATED: October 19, 2011

LUCE, FORWARD, HAMILTON & SCRIPPS LLP

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6 By: /s/Diana D. Herman, Esq., CSBN 191384
7 Diana D. Herman
8 Counsel for David Bradlow, Chapter 11 Trustee
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